No. 96-592

Supreme Court, U.S.
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In The

Supreme Court of the United States

October Term, 1996

SPEAR, LEEDS & KELLOGG,

Petitioner,

v.

CENTRAL LIFE ASSURANCE COMPANY, ALEXANDER HAMILTON LIFE INSURANCE COMPANY OF AMERICA, INC., AND CANADA LIFE ASSURANCE CO.,

Respondents.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Second Circuit

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QUESTION PRESENTED

Whether under provisions of the New York Stock Exchange, Inc. ("NYSE") Constitution and Rules, NYSE members are compelled to arbitrate claims of any other person, including non-members of the NYSE, where the dispute arises out of or in connection with the business of the member.

RULE 29.6 STATEMENT

Respondents Central Life Assurance Company (now known as AmerUs Life Insurance Company), Alexander Hamilton Life Insurance Company of America, Inc. and Canada Life Assurance Company hereby state the following:

1. Central Life Assurance Company (now known as AmerUs Life Insurance Company) states that American Mutual Holding Company owns AmerUs Group Company which in turn owns AmerUs Life Insurance Company, which has no nonwholly owned subsidiaries.

2. Canada Life Assurance Company states that it has no parent company and no nonwholly owned subsidiaries.

3. Alexander Hamilton Life Insurance Company of America, Inc., states that it is a wholly-owned subsidiary of Jefferson-Pilot Corporation. It has no nonwholly owned subsidiaries.

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STATUTES AND REGULATIONS INVOLVED

In addition to those cited by Petitioner this responsive brief also cites 15 U.S.C. § 78s(c), which reads as follows:

> **(c) Amendment by Commission of rules of self-regulatory organizations**
>
> The Commission, by rule, may abrogate, add to, and delete from (hereinafter in this subsection collectively referred to as "amend") the rules of a self-regulatory organization (other than a registered clearing agency) as the Commission deems necessary or appropriate to insure the fair administration of the self-regulatory organization, to conform its rules to requirements of this chapter and the rules and regulations thereunder applicable to such organization, or otherwise in furtherance of the purposes of this chapter, in the purposes of this chapter, in the following manner: (Subparagraphs (1)-(4) omitted)

STATEMENT OF THE CASE

The Statement presented by Petitioner Spear, Leeds & Kellogg ("SLK") is argumentative, incomplete and fails to adhere to the requirements of Rule 14(1)(g). For those reasons respondents submit the following Statement of the Case, including the procedural history and the decisions of the courts below.

I. Statement of Facts

Marvin Goodman, reputedly a successful commodities trader for himself and a number of other persons in his unregistered commodity pool, perpetrated a fraud of massive proportions on his commodity pool members and a number of life insurance companies, including the respondents. Like so many of the notorious financial frauds of our time, Goodman was able to perpetrate this fraud through the use of false and secret accounts sanctioned by SLK who played a vital and necessary role in Goodman's fraud. SLK held accounts for Goodman's pool members and prepared and mailed monthly account statements that substantially overstated the value of the pool members' "segregated funds" in and cash additions to those accounts. Goodman used these same fraudulent SLK monthly account statements to justify his need for additional life insurance issued by the respondents.

SLK – as a registered futures commission merchant and a member of the New York Stock Exchange ("NYSE") – agreed upon joining the NYSE to act in accordance with its Constitution and Arbitration Rules. Respondents, three life insurance companies, are not members of the Exchange, but have demanded arbitration pursuant to the Exchange's Constitution and Rules.

In November 1990 Goodman's fraudulent scheme faced a potentially fatal dilemma when he moved his commodity accounts from Balfour Maclain Futures, Inc. (a registered futures commission merchant). Without another broker, legitimately appearing accounts and account statements for his commodity pool members would have ceased. The fraudulent scheme continued

and expanded because Goodman was allowed to open, at SLK, accounts (approximately 86) for Goodman and his commodity pool members.

Goodman's clients' accounts were listed on SLK records as "sub-accounts" of Goodman's account. As such, the accounts were allegedly charged a lower commission rate. Professing concern that should he die suddenly, delays in the probate of his estate might create certain risks in his sub-account arrangement, Goodman purchased life insurance and put it in irrevocable trusts so that upon his death his clients would immediately be paid the equity balances in their accounts. At the end of 1990 the trusts held $20 million of life insurance on Goodman's life.

Because of his expanding commodity trading business, Goodman set out in 1991 to augment this life insurance plan. The three respondent insurance companies were persuaded to issue additional life insurance policies totalling $3 million. To obtain this additional insurance Goodman provided respondents with detailed financial information regarding his accounts at SLK. Respondents were shown the broker's account statements that were sent to Goodman's commodity pool members, with significant positive account balances held in "segregated funds" of between $17.5 and $20.5 million. The true account values, it is now conceded, were actually closer to $2 million.

Goodman's plans for the protection of his clients' financial security did protect them on his untimely death, but for the respondent insurance companies, Goodman's

plans proved to be fraudulent. According to the respondents' statement of claim filed in arbitration before the NYSE, SLK's fraudulent account statements empowered Goodman's fraud to continue, not only upon his pool members, but also on respondents. These account statements provided a basis and justification for the additional insurance issued by respondents to Goodman.

According to the respondents, the monthly profits noted in the sub-account statements were illegitimate, a reflection of "arbitrary and concocted directions" from Goodman that bore no relation to his actual trading. The insurance companies further allege that the broker made numerous errors in maintaining its account records. It did not segregate the balances of Goodman's sub-accounts, as shown on the face of the statements, but instead internally listed the accounts on a "net basis," deducting from the aggregate sub-account values a secret account that carried a substantial debit balance. Hence, SLK is charged by respondents with preparing and mailing misleading and false monthly statements that misrepresented Goodman's trading activities and the reality of his financial condition.

In August 1991 the NYSE, while conducting a routine investigation, discovered Goodman's fraud. Jeffrey Zinn, an Exchange investigator, was alerted by the unusual number of sub-accounts (approximately 86) that Goodman had with SLK. The broker stated it knew only of Goodman's interest in the accounts, but it acknowledged mailing statements concerning the many sub-accounts to others. Although SLK had the names and addresses for mailing purposes, it maintained no opening account documents establishing these sub-accounts.

The Commodity Futures Trading Commission (Commission) also instituted an enforcement action and froze Goodman's assets. On December 17, 1991, before the conclusion of the Commission's proceedings, Goodman died. Accordingly, under the terms of the insurance trusts, Goodman's investment clients received payments from the insurance companies equal to the reported equity the clients thought they had in the SLK sub-accounts. Respondents argue that these insurance monies saved Goodman's clients, the individual victims of the fraud, from any loss, and in fact provided SLK with a windfall because, but for the insurance proceeds that satisfied payment of SLK's false account values, SLK would have been responsible for those reported "segregated funds" with an ending aggregate balance in excess of $20 million.

For its role in this tale of financial fraud, SLK was charged with violations of NYSE rules and the rules and regulations of the Commodity Futures Trading Commission. SLK consented to the imposition of a $75,000 fine and censure by the NYSE. The Commission also reached an agreement with SLK in which the broker consented to a $325,000 penalty and its managers were fined and suspended for their activities in connection with Goodman's accounts.

II. Procedural History

These developments led to three actions by the parties. On December 15, 1993, respondents filed an arbitration proceeding against petitioner SLK by filing a Statement of Claim before the NYSE alleging negligent

misrepresentation, fraud and conspiracy, negligence, equitable subrogation and RICO violations, all arising out of the business of SLK. Thereafter, on or about February 8, 1994, SLK filed its complaint in the United States District Court for the Southern District of New York, seeking in part a preliminary injunction enjoining respondents from compelling SLK to arbitrate before the NYSE, on the grounds that the dispute among SLK and respondents was not arbitrable before the NYSE.

The following week respondents filed a petition to compel SLK to arbitrate pursuant to 9 U.S.C. § 4 in the United States District Court for the District of Nebraska. Thereafter, respondents agreed to a voluntary stay of that action pending the outcome in New York. (Respondents did not seek a stay of the New York action under the Federal Arbitration Act because that court did not have the authority to compel arbitration in Omaha, Nebraska, the situs of the hearing in the NYSE proceeding, i.e. the city where the NYSE holds hearings closest to Central Life's home office). As a result, the parties stipulated that the issue of arbitrability would be decided in the New York federal district court.

On March 30, 1995, the New York district court entered an order granting SLK's motion for preliminary injunction enjoining respondents from compelling SLK to arbitrate finding, *inter alia*, that there was an insufficient relationship between the parties to render the matter arbitrable before the NYSE.

On appeal the Second Circuit reversed. It held that the controversy fell within the scope of a valid arbitration agreement between the parties and therefore the district

court had erred in granting a preliminary injunction barring arbitration.

REASONS FOR DENYING THE WRIT

Introduction

The Second Circuit's decision requiring arbitration of the dispute between SLK and respondents involved only application of this Court's well-settled arbitration law; did not enlarge upon any of those well-settled principles; did not establish any new law; and followed precedent that has no decisions in conflict. As in the courts below, SLK has misconstrued the issues and raised arguments not involved in this court proceeding. There is no reason and certainly no compelling reason for this Court to grant certiorari in this case and allow SLK to further delay an arbitration that was filed almost three years ago.

I. THE QUESTION PRESENTED INVOLVES WELL-SETTLED PRINCIPLES OF ARBITRATION LAW AND DOES NOT INVOLVE A QUESTION NEEDING REVIEW BY THIS COURT.

SLK misconstrues the narrow and simple issue presented in this case, namely, does the dispute between respondents and SLK arise out of or in connection with SLK's business within the meaning of the NYSE Constitution and Rules? The Second Circuit correctly concluded that the dispute did and that under the Federal Arbitration Act ("FAA") the matter was therefore arbitrable. In so holding the Second Circuit applied the well-settled

rules of arbitration law enunciated by this Court. In *Mastrobuono v. Shearson Lehman Hutton, Inc.*, ___ U.S. ___, 115 S.Ct. 1212 (1995) this Court held that the pro-arbitration policy of the FAA is to be given effect by ensuring that agreements to arbitrate are enforced, and further held that such policy cannot be frustrated by attempts to have an arbitrable dispute resolved outside the arbitration process. This Court had previously held that the FAA "establishes a federal policy favoring arbitration requiring that [this Court] rigorously enforce agreements to arbitrate." *Shearson/American Exp., Inc. v. McMahon*, 482 U.S. 220, 226 (1987) (internal quotes omitted). Those arbitration principles are also noted and followed in *Moses H. Cone Memorial Hospital v. Mercury Construction Corp*, 460 U.S. 1, 24 (1983), *Dean Witter Reynolds Inc. v. Byrd*, 470 U.S. 213, 221 (1985), and *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth*, 473 U.S. 614, 625-26 (1985). Furthermore, because of this policy, the presumption is that disputes fall within an agreement to arbitrate. *First Options of Chicago, Inc. v. Kaplan*, ___ U.S. ___, 115 S.Ct. 1920, 1924 (1995); *Moses H. Cone*, 460 U.S. at 24-25.

The decision of the Second Circuit simply applied those principles. Applying the proper two stage analysis, the Second Circuit first held that SLK entered into an agreement to arbitrate because of its membership in the NYSE and the NYSE Constitution and Rules providing for arbitration.[1] It then concluded that because the dispute arose in connection with the NYSE business of SLK,

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[1] NYSE Const. art. XI, § 1 provides: "[A]ny controversy . . . between a member . . . and any other person arising out of the business of such member . . . shall at the instance of any such party be submitted for arbitration in accordance with

the dispute was arbitrable. These concepts and applications are well established and no new law was created regarding the sole and simple issue here of whether this dispute is arbitrable.

The Second Circuit's holding is consistent with the pro-arbitration holdings of this Court and the federal policy favoring arbitration. None of SLK's arguments for certiorari presents issues that have not already been decided by this Court, and accordingly this Court's review should not be granted. Each of SLK's arguments will now be addressed.

II. THE SECOND CIRCUIT'S DECISION DID NOT EXPAND THE ARBITRATION DUTIES OF THE NYSE.

SLK's contention (Petition, pp. 7-9) that the Court of Appeals' decision "expanded the NYSE's role as arbiter far beyond that given to it by the Exchange Act – the

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the provisions of this Constitution and such Rules as the [NYSE] Board [of Directors] may . . . adopt.

NYSE Rule 600(a) provides: Any dispute, claim or controversy between a . . . nonmember and member, . . . arising in connection with the business of such member, . . . shall be arbitrated under the Constitution and Rules of the New York Stock Exchange, Inc. . . . upon the demand of the . . . nonmember.

"[T]he rules of a securities exchange are contractual in nature" and the NYSE Constitution and Rules "are sufficient to compel arbitration of [certain disputes] in the absence of a specific written arbitration agreement." *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Georgiadis*, 903 F.2d 109, 113 (2d Cir. 1990).

policing of members' relationships with investors, customers or employees, or others with whom Exchange members have a business relationship" is not supported by any case authority. None of the cases SLK cites concerns the sole issue in this case, i.e., whether the dispute between SLK and respondents is subject to arbitration. Rather, SLK argues that certiorari should be granted by impermissibly delving into the legal merits of this action (raising issues of privity and the need for a transaction between the parties).[2]

A NYSE member, through its membership in the NYSE, agrees to arbitrate "any controversy between a member . . . and any other person arising out of the business of such member . . . " (NYSE Const. art. XI, § 1) and "[a]ny dispute, claim or controversy between a . . . non-member and member . . . arising in connection with the business of such member . . . " (NYSE Rule 600(a)). The Second Circuit held that these arbitration provisions are themselves contractual in nature and therefore can serve as the basis for compelling arbitration of exchange related disputes. The Second Circuit found such provision created a contractual basis for arbitration and *SLK does not directly dispute the correctness of that holding*. The Second Circuit also held that the express

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[2] This Court has long held that in considering the issue of whether a dispute was arbitrable, the court should not consider or weigh the underlying merits of the dispute. *AT&T Technologies, Inc. v. Communications Workers of America*, 475 U.S. 643, 649-650 (1986); *Prima Paint Corp. v. Flood & Conklin Manufacturing Co.*, 388 U.S. 395, 404 (1967); *United States Steelworkers of America v. American Manufacturing Company*, 363 U.S. 564, 568 (1960).

language of NYSE Rule 600(a) does not require a contract between the parties to a controversy as a precondition to arbitration where the claim concerns the business of a member (like SLK) and the non-member (like respondents) demands arbitration. Again, *SLK does not directly dispute the correctness of that holding.*

SLK's reliance on *dicta* in *Silver v. New York Stock Exchange*, 373 U.S. 341 (1963) and *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Ware*, 414 U.S. 117 (1973) fails to recognize the holdings in those cases. *Silver* did not even involve arbitration, but rather whether and to what extent the federal anti-trust laws apply to the activities of the NYSE. *Silver* simply held that the NYSE was subject to the anti-trust laws. In reaching that conclusion the Court *in dicta* makes the observations about self-regulation upon which SLK relies. But that dicta supports respondents and the holding of the Second Circuit. Self-regulation is not frustrated by the Second Circuit's decision; instead the requirement that SLK arbitrate this dispute before the NYSE (in a matter already before the NYSE by way of its audit and the subsequent fines and censures of SLK) furthers the self-regulation of the Exchange's members and ensures that the legality of SLK's business activities, *for which SLK was fined and censured by the NYSE*, is resolved in an NYSE arbitration.

Ware only held that a NYSE rule which required arbitration of employment disputes was superseded by a California state statute which allowed an aggrieved employee to proceed in court notwithstanding the contractual agreement to arbitrate. As this Court later noted, *Ware* allowed the state law to prevail only because the FAA was not involved, and when the FAA and its policies

are implicated, as is clearly the case here, the pro-arbitration policy of the FAA must be given effect, even if state law is to the contrary. *Perry v. Thomas*, 482 U.S. 483 (1987).[3]

The irony here is that most often it is the industry member that seeks arbitration of controversies involving their business, especially claims by non-members. However SLK's complaints about self-regulation are not really with the Second Circuit's view of the law, but instead with what SLK deems to be an unfair rule when applied as a sword against it instead of a shield. Those complaints need to be addressed to either the NYSE, or to the Securities and Exchange Commission. *See* 15 U.S.C. § 78s(c); *Gordon v. New York Stock Exchange, Inc.*, 422 U.S. 659, 667 (1975); *McMahon*, 482 U.S. at 233-34 (NYSE arbitration procedures subject to review authority of SEC).

III. THE SECOND CIRCUIT'S DECISION DOES NOT EXTEND THE INTENT OF THE PARTIES IN CONTRAVENTION OF THE LIMITS ON ARBITRABILITY UNDER THIS COURT'S JURISPRUDENCE.

SLK's contention (Petition, p. 10) that the ruling of the Second Circuit "goes far beyond the 'intent of the parties' limit on arbitrability set by this Court's jurisprudence" misconstrues those holdings and, *again*, is really a complaint about the NYSE rules themselves. SLK cites

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[3] Here the state law of the forum is not contrary to the Second Circuit's holding, but is wholly supportive. *Nomura Securities International, Inc. v. Citibank*, 81 N.Y.2d 614, 601 N.Y.S. 2d 448 (1993).

three cases from this Court, none of which supports its position. In *Mitsubishi Motors*, the Court not only held the dispute was arbitrable, but also noted the permissive policy with respect to arbitration. *Id.*, 473 U.S. at 626. That policy was reiterated in *First Options* where this Court stated that "issues will be deemed arbitrable unless 'it is clear that the arbitration clause has not included' them." *Id.*, 115 S.Ct. at 1924-25, quoting G. Wilner, 1 Domke on Commercial Arbitration § 12.02, p. 156 (rev. ed. Supp. 1993). SLK's reliance on *Volt Information Sciences, Inc. v. Board of Trustees of Leland Standford Junior Univ.*, 489 U.S. 468 (1989) also ignores that this Court held only that application of a California statute which conflicts with the FAA is not preempted by the FAA where the parties have agreed that their arbitration agreement will be governed by California law. *Volt* not only does not conflict with the Second Circuit, it reaffirms those principles, since *Volt's* holding required the parties to follow the arbitration rules which the parties had agreed to follow. *Id.* at 479. The Second Circuit's decision reaffirms all of the principles followed in those cases.

IV. THE SECOND CIRCUIT'S DECISION IS NOT CONTRARY TO ANY OTHER CIRCUIT

Though not explicitly stated SLK's "last gasp" contention (Petition, pp. 12-13) appears to be that the effect of the Second Circuit's decision is in conflict with *Wheat, First Securities, Inc. v. Green*, 993 F.2d 814 (11th Cir. 1993). The *Wheat, First* decision is easily distinguishable. The dispute in that case arose between Green and another brokerage firm. Wheat, First happened upon the scene

when it purchased the assets of the other brokerage firm well after the alleged fraudulent stock transaction. Wheat, First expressly did not assume any liability of the other brokerage.

First, the theories of arbitrability in *Wheat, First* were based on a claim that the defendants were "customers" of Wheat, First and that Wheat, First was the successor in interest to the brokerage house where the alleged fraud occurred. The second theory is wholly inapplicable here. Moreover the first theory was premised on the language of the rules of the *National Association of Securities Dealers* ("NASD") not the Constitution and Rules of the NYSE.

Second, the Eleventh Circuit's decision focused solely on the issue of whether or not defendants were "customers" of Wheat, First premised on the narrower language of the NASD's arbitration provisions as compared with those of the NYSE.[4] For that reason the Eleventh

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[4] *Compare* NASD Code of Arbitration Procedure, Sec. 1: "This Code of Arbitration Procedure is prescribed and adopted . . . for the arbitration of any dispute, claim, or controversy arising out of or in connection with the business of any member of the Association . . . (2) between or among members and public customers, or others . . . " and

Sec. 12 (a) "Any dispute, claim, or controversy eligible for submission under Part I of this Code between a customer and a member . . . arising in connection with the business of such member . . . shall be arbitrated under this Code, . . . upon demand *of the customer.*" (emphasis added), *with* NYSE Rule 600(a) "Any dispute, claim or controversy between a customer or non-member and a member . . . arising in connection with the business of such member . . . shall be arbitrated under the Constitution and Rules . . . upon demand *of the customer or non-member.*" (emphasis added). Respondents were well aware of

Circuit never reached the issues dispositive here, i.e., whether the claims arose in connection with the business of the NYSE member and whether that membership was a sufficient basis for compelling arbitration of the dispute between the member and non-member. The Eleventh Circuit expressly left open the tantalizing question of whether Wheat, First must submit to arbitration by virtue of its NASD membership. *Id.* at 820-821.

The Second Circuit decision here is fully consistent with *Pearce v. E.F. Hutton Group, Inc.*, 828 F.2d 826 (D.C. Cir. 1987) which also required arbitration of a dispute pursuant to NYSE Rule 600(a).

CONCLUSION

As this Court stated in *Mitsubishi Motors*, 473 U.S. at 626-27:

> [W]e are well past the time when judicial suspicion of the desirability of arbitration and of the competence of arbitral tribunals inhibited the development of arbitration as an alternative means of dispute resolution.

The Second Circuit correctly applied the principles established by this Court in holding that the dispute between SLK and respondents, upon their demand, must be arbitrated. The Second Circuit decision does nothing more than follow the established policy that parties who commit themselves to arbitration are bound to that duty.

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this distinction when their demand for arbitration was filed with the NYSE.

No conflicts in the law are created by this decision. No error of law is presented. There simply is no reason for this Court to review this matter and further delay arbitration.

For all of the foregoing reasons, the Writ of Certiorari should be denied.

Respectfully submitted,

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